

Message Text

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PAGE 01 STATE 121548
ORIGIN SS-25

INFO OCT-01 ISO-00 SSO-00 /026 R

DRAFTED BY EB/ORF/FSE:PEBARBIAN:MEP
APPROVED BY EB - PAUL BOEKER
EB/ORF/FSE - LRRACHT
EUR/CAN - JROUSE
FEA - RSANDS
WHITE HOUSE - HBERGOLD
E - LROSS (SUBS)
S/S.A. OTTO

-----260217Z 047846 /65

O 260057Z MAY 77
FM SECSTATE WASHDC
TO AMEMBASSY OTTAWA IMMEDIATE

C O N F I D E N T I A L STATE 121548

STADIS/////////
EXDIS

E.O. 11652: GDS

TAGS: ENRG, CA

SUBJECT: NATURAL GAS PRICE INCREASE

REF: OTTAWA 4154

1. CHARGE IS REQUESTED TO APPROACH GOC AT MINISTERIAL
LEVEL TO MAKE PRESENTATION ALONG LINES OF PARA 3, AND
TO LEAVE AIDE MEMOIRE (TEXT IN PARA 4). DEPARTMENT BE-
LIEVES THAT IT WOULD BE USEFUL FOR AMBASSADOR TO CONTACT
GILLESPIE AND MAKE SAME POINTS AFTER CHARGE HAS PRE-
SENTED AIDE MEMOIRE. SCHLESINGER WILL ALSO BE ASKED
TO TELEPHONE GILLESPIE FOLLOWING CHARGE AND AMBASSADOR'S
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DEMARCHES. PLEASE KEEP DEPARTMENT INFORMED OF CANADIAN
REACTION.

2. THE OBJECTIVE OF THESE APPROACHES TO THE GOC IS
THREE-FOLD:

-- TO PERSUADE THE GOC TO REDUCE PROPOSED NEW

PRICE LEVEL FOR NATURAL GAS EXPORTS BELOW US\$2.25

-- TO OBTAIN GOC AGREEMENT TO BEGIN MOVEMENT TOWARD CLOSING DISCRIMINATORY GAP BETWEEN EXPORT PRICES AND CANADIAN DOMESTIC PRICES

-- TO PHASE IN ANY PRICE INCREASE IN AT LEAST TWO STAGES

THE AIDE MEMOIRE SPECIFICALLY AVOIDS SUGGESTING A PRICE LEVEL WE WOULD FIND ACCEPTABLE. OBVIOUSLY, WE WANT THE LOWEST POSSIBLE PRICE. AS A STARTING POINT IN DISCUSSIONS WITH THE GOC IT MAY BE USEFUL TO EMPHASIZE THE POINT MENTIONED IN PARA 1D OF REFTEL; THAT THE GOC'S OWN METHODOLOGY DOES NOT JUSTIFY A PRICE ABOVE US\$2.18.

3. TALKING POINTS

-- WE APPRECIATE ADVANCE NOTICE OF NEB RECOMMENDATION AND THE OPPORTUNITY TO CONSULT BEFORE FINAL DECISION IS MADE

-- THE PROPOSED INCREASE OF APPROXIMATELY 22 PERCENT (US\$1.84 TO US\$2.25) IS EXCESSIVE AND WILL HAVE A SEVERE IMPACT ON U.S. CONSUMERS WHO ARE HEAVILY DEPENDENT ON CANADIAN GAS

-- THE US STRONGLY OBJECTS TO CONTINUED PRICE DISCRIMINATION AGAINST US CONSUMERS RESULTING FROM HIGHER CONFIDENTIAL

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PRICES FOR EXPORT GAS THAN FOR GAS CONSUMED IN CANADA.

-- THE GOC HAS NOT YET ANNOUNCED NEW DOMESTIC GAS PRICES. WE EXPECT THAT THE NEW GAS PRICE WILL RESULT IN BOTH AN ABSOLUTE AND RELATIVE NARROWING OF THE DISCRIMINATORY GAP. THIS IS CONSISTENT WITH THE EXPECTATION WE HAD AS A RESULT OF 1976 CONSULTATIONS ON NATURAL GAS EXPORT PRICES.

-- THE USG WOULD EXPECT OUR CONSULTATIONS ON THIS YEAR'S GAS PRICE INCREASE TO REMAIN OPEN UNTIL WE KNOW WHAT THE FINAL RELATIONSHIP WILL BE BETWEEN EXPORT PRICES AND CANADIAN DOMESTIC PRICES.

-- WE NOTE THE REFERENCE TO THE REPLACEMENT VALUE OF IMPORTED ENERGY INTO EASTERN CANADA IS CALCULATED AT CDN\$2.28. THAT IS EQUIVALENT TO US\$2.18, NOT US\$2.25.

-- IN VIEW OF THE TREND IN US POLICY TOWARD PRICING

NATURAL GAS AT COMMODITY VALUE, WHICH IS THE SAME METHODOLOGY USED BY THE GOC, US AND CANADIAN GAS PRICES SHOULD BEGIN TO CONVERGE. WE WOULD LIKE THAT CONVERGENCE TO BEGIN THIS YEAR THROUGH A MORE MODERATE PRICE INCREASE.

-- THE GOC SHOULD BEAR IN MIND THAT THE HIGH PRICES PAID IN THE US FOR NATURAL GAS LAST WINTER RESULTED FROM AN EMERGENCY SITUATION AND ARE NOT REPRESENTATIVE OF THE CURRENT LEVEL OF GAS PRICES IN THE US.

-- GIVEN THE SEVERE IMPACT ANY PRICE INCREASE WILL HAVE ON US CONSUMERS THE USG REQUESTS THAT THE INCREASE BE PHASED IN GRADUALLY AGAIN THIS YEAR AS IT WAS LAST YEAR; ONE-HALF OF THE INCREASE MIGHT BE IMPLEMENTED NO SOONER THAN SEPTEMBER 1, AND THE REMAINING HALF SOMETIME AFTER JANUARY 1, 1978.

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4. BEGIN TEXT OF AIDE MEMOIRE.

THE GOVERNMENT OF U.S. APPRECIATES HAVING RECEIVED FROM THE EMBASSY OF CANADA IN WASHINGTON A COPY OF THE REPORT OF THE NATIONAL ENERGY BOARD TO THE GOVERNOR IN COUNCIL CONCERNING THE PRICE OF NATURAL GAS EXPORTED TO THE UNITED STATES.

THE PROPOSED INCREASE IN PRICE FROM CDN\$1.94 (US\$1.84) TO US\$2.25 PER THOUSAND CUBIC FEET REPRESENTS AN INCREASE OF MORE THAN 22 PERCENT. AN INCREASE OF THIS MAGNITUDE WILL HAVE A SEVERE IMPACT ON THE MANY US CONSUMERS WHO ARE HEAVILY DEPENDENT ON CANADIAN NATURAL GAS. IT IS THE VIEW OF THE GOVERNMENT OF U.S. THAT THE PROPOSED PRICE OF US\$2.25 PER THOUSAND CUBIC FEET IS EXCESSIVELY HIGH AND CANNOT BE JUSTIFIED BY ANY REASONABLE METHODOLOGY.

THE IMPACT OF A VERY LARGE PRICE INCREASE WILL BE ESPECIALLY DIFFICULT TO BEAR IF THE GOVERNMENT OF CANADA CONTINUES TO DISCRIMINATE AGAINST US CONSUMERS BY MAINTAINING THE EXPORT PRICE OF NATURAL GAS AT A LEVEL ABOVE THE PRICE PAID BY CANADIAN CONSUMERS. THE GOVERNMENT OF U.S. AGAIN EXPRESSES ITS STRONG OPPOSITION TO DISCRIMINATORY PRICING. THE CURRENT TORONTO CITY-GATE PRICE OF CDN\$1.505 PER THOUSAND CUBIC FEET IS 29 PERCENT LOWER THAN THE CURRENT EXPORT PRICE OF CDN\$1.94 PER THOUSAND CUBIC FEET. ALTHOUGH THE GOVERNMENT OF CANADA HAS NOT YET ANNOUNCED A NEW PRICE FOR NATURAL GAS SOLD IN CANADA RECENT REPORTS OF AN INCREASE IN THE PRICE OF CANADIAN CRUDE OIL BY CDN\$2. PER BARREL SEEM TO INDICATE THAT THE NEW NATURAL GAS PRICE WILL CAUSE BOTH AN ABSOLUTE AND

RELATIVE INCREASE IN THE DISCRIMINATION AGAINST US CONSUMERS OF CANADIAN NATURAL GAS.

IN VIEW OF THE PROPOSED CHANGES IN U.S. POLICY TOWARD PRICING OF NATURAL GAS AT COMMODITY VALUE, WHICH
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IS THE SAME PRICING METHOD USED IN CANADA, NATURAL GAS PRICES IN THE U.S. AND CANADA SHOULD BEGIN TO CONVERGE. THE DEPARTMENT OF STATE WOULD APPRECIATE ASSURANCES FROM THE GOVERNMENT OF CANADA ON THIS ISSUE.

WE NOTE THAT THE NATIONAL ENERGY BOARD HAS AGAIN CHANGED ITS METHODOLOGY FOR DETERMINING THE PRICE OF NATURAL GAS EXPORTS. FOR 1977, THE METHODOLOGY TAKES INTO ACCOUNT THE COST TO CANADIANS OF IMPORTING ENERGY AT WORLD PRICES. ANALYSIS CARRIED OUT BY THE GOVERNMENT OF THE UNITED STATES DOES NOT SUPPORT THE NEB'S CONCLUSION THAT THE COMMODITY VALUE OF NATURAL GAS IS NOW US\$2.25 PER THOUSAND CUBIC FEET. IN ITS REPORT, THE NATIONAL ENERGY BOARD CITED PRICES PAID FOR NATURAL GAS IN THE U.S. DURING THE PAST WINTER. IT SHOULD BE NOTED THAT THOSE PRICES WERE APPLICABLE TO A SMALL PROPORTION OF THE TOTAL GAS SUPPLY IN THE U.S. AND WERE APPLICABLE ONLY DURING A PERIOD OF EMERGENCY. THEY WERE NOT INDICATIVE OF THE GENERAL LEVEL OF GAS PRICES IN THE U.S.

IN ORDER TO EASE THE ADJUSTMENT TO THE NEW PRICE, THE DEPARTMENT OF STATE REQUESTS THAT ANY PRICE INCREASE BE IMPLEMENTED IN TWO STAGES. IT IS REQUESTED THAT ONE-HALF OF THE INCREASE BE IMPLEMENTED NO SOONER THAN SEPTEMBER 1, 1977, AND THE REMAINING HALF ON, OR AFTER, JANUARY 1, 1978. END TEXT OF AIDE MEMOIRE. VANCE

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